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COMMITTEE ON
WAYS AND MEANS

SUBCOMMITTEE ON
SOCIAL SECURITY
RANKING DEMOCRAT

WHIP AT LARGE

Congress of the United States
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Robert.Matsui@mail.house.gov

September 7, 2001

The Honorable Dick Armey
Majority Leader
U.S. House of Representatives
U.S. Capitol H-329
Washington, DC 20515

Dear Dick:

Thank you for your letter of September 5th.

The financing shortfall in Social Security is indeed a challenge, but it is not a crisis. I became the Ranking Member of the Social Security Subcommittee exactly because I knew the system faced a long-term financing shortfall. I have said, and I continue to maintain, that incremental changes that do not alter the fundamental insurance-based structure of Social Security or its role as a secure foundation of retirement income are needed to extend the solvency of Social Security. And these changes should be made sooner rather than later. The development of such a plan requires a bipartisan dialogue among members of Congress and the White House, not the pre-ordained outcome of a presidential commission with a mandate to privatize Social Security.

One way to put the financing challenge into context is to recognize that over the next 75 years Social Security will need an additional $3 trillion in present-value terms, or 0.7% of GDP to meet all its benefit obligations. Compare Social Security's financing shortfall to the recently passed tax cut, which without sunsets will cost $7.7 trillion in present-value terms over that same period, or 1.6% of GDP. This comparison makes it clear that not only is balancing Social Security's books manageable, but the recently passed tax cut used resources that could have gone a long way to restoring solvency.

The privatization solution you propose will do severe harm to the existing system. Carving private accounts out of Social Security cannot bring the system into balance. In fact, diverting resources from the Trust Funds and into private accounts *more than doubles* the size of the financing gap, and requires more drastic changes than would otherwise be necessary.

Proponents of privatization do not want to spell out the details of their plans. If you are committed to going down the path of privatization, we need to be honest about the costs and trade-offs of such a radical change so the American public will know what it is getting into. For example, how will the Administration pay for the multi-trillion-dollar cost of starting a private account system while continuing to pay for benefits to current beneficiaries? After the tax cut, there is no on-budget surplus and the President has ruled out tax increases, leaving privatizers with no choice other than to make deep cuts in guaranteed Social Security benefits and significantly increase the retirement age.

Based on my careful study of private accounts, I know that it is not possible to restore long-term solvency to Social Security and create individual accounts without net cuts in beneficiaries' income, even including their private account. The math simply does not add up. The Congressional Research Service showed this in a recent study, "Social Security: What Happens to Future Benefit Levels Under Various Reform Options." When CRS considered a proposal that would make Social Security solvent and create individual accounts by diverting payroll taxes away from the Trust Funds, the combined effect of reduced Social Security benefits plus individual accounts would be at least 8% lower than current law. And this study did not factor in the cost of the transition, which would entail additional benefit reductions on top of the 8% cut.

Aside from the question of what kinds of benefit cuts would be adopted as part of a move to privatize the system, private accounts simply cannot provide the same kinds of protections that Social Security provides. Social Security is an insurance program, offering benefits and protections that no individual investment program can provide. Unlike a private account, Social Security pays guaranteed monthly benefits for life with no risk of investment loss. Social Security benefits are fully protected against inflation. Family members, such as widows and young children, receive Social Security benefits with no reduction in the worker's own benefit. Social Security provides income security to disabled workers and their families that cannot be matched by personal savings, and which is unavailable in the private market.

Privatization presents a particular danger to members of minority groups. Because many members of minority groups have below-average earnings, they particularly gain from Social Security's progressive benefit structure, which would be eroded with the imposition of individual accounts. In addition, people of color on average have a higher likelihood of career-ending disability and lower life expectancies. Thus, they benefit particularly from Social Security protections for disabled workers and for the families of disabled or deceased workers. These benefits are among those that are most threatened by substituting private accounts for current Social Security.

With private accounts, the devil is truly in the details. Who will decide which investments are appropriate? How much will management fees erode an account? How will beneficiaries be protected from erosion of their income due to inflation? Will the government make up losses for unlucky or unwise investors? Who will educate inexperienced investors on the safest way to protect their retirement income? Would retirees be protected against outliving their assets? If they were forced to purchase an annuity, then they would be unable to pass on income to their heirs. If they do not purchase an annuity and outlive their assets, would the government give them additional income?

In England, where workers are permitted to opt-out of the national social security system and instead set up an individual account, the government had to impose strict fines and new regulations on investment firms when it found these firms had encouraged workers to make poor investments and gouged account holders with high administrative fees. Do you intend to impose new restrictions on and policing of the securities industry and financial service providers in order to assure that American workers do not fall prey to the same tactics?

Social Security has been tremendously successful in assuring dignity and economic security to American workers and their families. For 6 out of 10 elderly, Social Security provides the majority of their income. Absent the program, more than half would live in poverty. There is no need to abandon this insurance system for a high-risk, family-unfriendly and insecure system of individual investment accounts.

I also want to respond to your comments on the Social Security Trust Fund. Dick, you cannot play all sides on the matter of the Trust Funds. At least seven times in the past you have voted to put both the Social Security and Medicare surpluses into a lockbox. This year on July 11, you said, "we must understand that it is inviolate to intrude" on these Trust Funds. Now in your letter to me this month you assert that the Trust Funds have no real economic value. Why protect them if they hold no value?

Here is what Chairman Greenspan has said about the Trust Funds: "The crucial question: Are they ultimate claims on real resources? And the answer is yes." Moreover, on July 25, 2001, your former colleague Bill Archer told a CATO Institute Briefing that "You as a conservative need to recognize that because when conservatives go to the public and say there is nothing in the trust fund that is just not true. It is the equivalent of EE bond that I bought for my grandchildren. It has the full faith and credit of the Federal Government behind it."

Alan Greenspan and Bill Archer are right; the Trust Funds do have value. I think you know it too, since it appears that you are poised to cash out part of the surplus to pay for the tax cut. In fact, White House Budget Director Mitch Daniels confirmed this week that the Administration will use $14 billion in Trust Funds assets to pay for other spending the President has requested. If we are to have a "cool and deliberative" debate on Social Security, then you cannot use the Trust Funds surpluses to pay for the tax cut, while simultaneously arguing that they are worthless to support your push for privatization.

Finally, to clear up another matter once and for all, I attach a letter regarding the Clinton 2000 budget. It is from Jack Lew, former OMB Director. He explains why some language in the Clinton 2000 budget provided an incorrect explanation of the Trust Funds for years with a unified budget surplus. As Lew indicates in his letter, he testified to the Senate that the Clinton 2000 budget was an error and subsequent Clinton budgets did not include this language.

Despite what the President's Social Security commission would like the American public to believe, the choices for Social Security are not either privatization or insolvency. I am committed to finding the best solutions that will provide long-term solvency for the program, without destroying Social Security's guarantee of a promised monthly income, livable survivors and disability benefits, and protection against inflation. I look forward to working with you and the rest of my colleagues to reach these goals.

Sincerely,

Robert T. Matsui

ROBERT T. MATSUI
Ranking Member
Social Security Subcommittee
Committee on Ways and Means

Attachment

Jacob J. Lew

July 19, 2001

Honorable Robert T. Matsui
2308 Rayburn House Office Building
Washington, D.C. 20515-0505

Dear Congressman Matsui,

Thank you for your inquiry regarding the budgetary treatment of the Social Security Trust Fund.

As I mentioned to you in our conversation, the technical documents associated with the submission of the FY 2000 budget contained an outdated presentation on the Social Security Trust Funds which did not accurately reflect either my own view or the view of the Clinton Administration on this important issue. While this technical presentation was correct when we were running deficits, it was no longer correct after we began to run a surplus and pay down the debt. As I recollected, this issue was in fact raised at the budget hearings that year. My response at the time indicated our correct views, as did our subsequent budget submission which contained a correct presentation.

Baseline budget projections assume that trust fund assets will be redeemed as needed to pay benefits. When there was a unified budget deficit, it was fair to question whether the assets of the trust fund could be redeemed without raising taxes, cutting spending or adding to the public debt. In striking contrast, in any year when baseline projections forecast a surplus after the trust fund assets are redeemed, it is not necessary to raise taxes, cut spending or increase public borrowing to make such payments. The Clinton Administration's final long term baseline budget projections forecast adequate surpluses to permit the entire Social Security Trust Fund to be redeemed as needed without requiring tax increases, spending cuts or additional borrowing. This does not mean that it is desirable policy to exhaust the Trust Fund, but simply that the fiscal condition of the U.S. Government would permit the Trust Fund to be fully redeemed.

Social Security Trust Fund bonds are backed by the full faith and credit of the United States, just like Treasury bills and savings bonds. In our entire history we have never defaulted on bond obligations. Treasury securities in the Social Security Trust Fund should not be viewed as second class securities, and fiscal policy should anticipate and accommodate the need to redeem Trust Fund assets.

While the Social Security Reform Act of 1983 created substantial Social Security Trust Fund balances, large unified budget deficits undermined confidence in our fiscal ability to repay these bonds. After the turnaround in 1998 from deficit to surplus, combined with a bipartisan agreement to save the Social Security surplus, these fears should have been put to rest. It is not a technical problem, but rather the result of a misguided fiscal policy if it once again becomes necessary to either raise taxes, cut spending or increase borrowing to redeem the assets of the Social Security Trust Fund

I hope that this letter will correct any misimpression that may be created by the unfortunate use of an erroneous technical document. I have attached an excerpt from the FY 2000 budget hearings in February 1999 as well as the revised presentation in the technical documents associated with the submission of the FY 2001 budget.

Sincerely,

Jacob J. Lew

PRESIDENT'S PROPOSED BUDGET FOR FISCAL YEAR 2000

TUESDAY, FEBRUARY 2, 1999

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:06 a.m., in room SD–608, Dirksen Senate Office Building, Hon. Pete V. Domenici (chairman of the committee) presiding.

Present: Senators Domenici, Gramm, Bond, Gorton, Gregg, Snowe, Frist, Grams, Smith, Lautenberg, Hollings, Conrad, Sarbanes, and Wyden.

Staff present: G. William Hoagland, staff director; and Amy Smith, chief economist.

For the minority: Bruce King, staff director and Sue Nelson, director of budget review and analysis, senior analyst for medicare.

OPENING STATEMENT OF CHAIRMAN DOMENICI

Chairman DOMENICI. The hearing will please come to order.

Good morning, Director Lew, Senator Lautenberg, and fellow Senators. I think this is the first time, Director Lew, that you have testified before this committee in your new capacity as Director. We welcome you. We compliment the President on appointing you, and we are glad to have been a part of getting you confirmed.

Mr. LEW. Thank you very much, Senator. I appreciate it.

Chairman DOMENICI. I will be brief in my opening remarks. I believe most of what I have to say was already said yesterday, and we want to leave plenty of time for your testimony and questioning by Members, but let me make just a couple of brief observations.

First, I think it is very clear now that we enter an era of surpluses for as far as the eye can see, and I never thought I would be able to make that statement, but I think it is pretty close to being an accurate assessment of where we are. We are all in agreement that the surpluses of the Social Security Program should be set aside and used to preserve that program.

Substantive changes in that program will obviously take place as the President and the Congress work together, but applying 62 percent of the projected surpluses to Social Security will not solve the problem all by itself.

During that period, when we have set it aside, the near-term debt held by the public will be affected. It is a positive first step in this budget, but I have some questions about the mechanics of setting aside this 62 percent.

But then you turn right around and take $81.4 billion of the same money and you buy Government bonds and you give it to Social Security and you say that Social Security now has not $129.5 billion, but has $129.5 billion plus $81.4 billion.

Now how come—and it worries Senator Domenici. Again, it does not worry me because it is just—you could give them a cigar box full of these pieces of paper, it would not make any difference to me, because I know it is just paper. But it worries Senator Domenici because he sees that you have given them $129.5 billion of paper, and now you are claiming that you are giving them with their own money $81.4 billion of additional Government debt.

Now you are going to argue that you actually reduce the outstanding debt of the Government by $81.4 billion, and so there is something different about this than there was on the other money, right?

Mr. LEW. That is part of the argument.

Senator GRAMM. OK, but let me tell you why it is false. [Laughter.]

Mr. LEW. I have not had a chance to argue it yet.

Senator CONRAD. Mr. Chairman, we have got about 10 minutes, not 5 minutes. Are we going to have some kind of fair order here, or are we just——

Chairman DOMENICI. Yes, we are. I asked him to try and get an answer. I will give you 10 minutes, if you would like.

Senator GRAMM. If it had not been for Social Security's $129.5 billion you would have had to borrow all that money, so the public debt would have been higher by $129.5 billion. So how is that piece of paper any different than the $81.4 billion? You would have had to borrow that much money——

Mr. LEW. If I could respond briefly.

Senator GRAMM [continuing]. That much less of public debt.

Chairman DOMENICI. All right, time is up.

Mr. LEW. If I might, Mr. Chairman, respond briefly?

Chairman DOMENICI. Sure.

Mr. LEW. Because I think that the paragraph that Senator Gregg read, what you are referring to, actually points out how much has changed. That paragraph has been written in technical documents for years and years and years, and it actually should have been revised this year because it is not technically accurate this year.

Technically, we are looking in our long term forecast at surpluses, with all of these bonds being repaid, until well into the 2040's. It used to be we were looking at deficits. And the reason that paragraph was written the way it is, is that there are a lot of things in the budget that have changed and that is a paragraph we should have revised.

Now as long as we are running a surplus, we can pay back the old bonds, we can pay back the new bonds and not borrow a penny more. But as Chairman Greenspan testified when he was here last week, if we get to the point where publicly held debt is down from 50 percent of the economy to 7 percent of the economy, if it is down from $4 trillion to about $1 trillion, it is not the worst thing in the world if 15, 20, 30 years from now we do have to borrow a little bit to pay Social Security benefits.

Now we would argue that to keep ourselves on the course towards reducing debt, is dependent on making wise decisions today. Tax cuts and spending today will increase the debt. Putting the money aside as we have proposed will reduce the debt. And I would argue that well beyond my 100th birthday we will be in pretty good shape.

Chairman DOMENICI. Senator Hollings?

Second, income excludes the offsetting collections, which are offset against outgo in revolving fund expenditure accounts instead of being deposited in receipt accounts.[5] It would be conceptually appropriate to classify these collections as income, but at present the data are not tabulated centrally for both fund groups. Consequently, they are offset against outgo in Table 15–1 and are not shown separately.

Some funds in the Federal funds group and some trust funds are authorized to borrow from the general fund of the Treasury.[4] Borrowed funds are not recorded as receipts and are excluded from the income of the fund. The borrowed funds finance outlays by the fund in excess of available receipts. Subsequently, fund receipts are transferred from the fund to the general fund in repayment of the borrowing. The repayment is not recorded as an outlay of the fund or included in fund outgo.

Some income in both Federal funds and trust funds consists of offsetting receipts. For most budget purposes, offsetting receipts are excluded from receipts figures and subtracted from gross outlays.

There are two reasons for this treatment:

- Business-like or market-oriented activities with the public The collections from such activities are deducted from gross outlays, rather than added to receipts, in order to produce budget totals for receipts and outlays that represent governmental rather than market activity.
- Intragovernmental transactions Collections by one Government account from another are deducted from gross outlays, rather than added to receipts, so that the budget totals measure the transactions of the Government with the public.

Because the income for Federal funds and for trust funds recorded in Table 15–1 includes offsetting receipts, those offsetting receipts must be deducted from the two fund groups' combined gross income in order to reconcile to total (net) unified budget receipts. Similarly, because the outgo for Federal funds and for trust funds in Table 15–1 consists of gross outlays, the amount of the offsetting receipts must be deducted from the sum of the Federal funds' and the trust funds' gross outgo in order to reconcile to total (net) unified budget outlays.

Income, Outgo, and Balances of Trust Funds

Table 15–2 shows the trust funds balance at the start of each year, income and outgo during the year, and the end of year balance. Income and outgo are divided between transactions with the public and transactions with Federal funds. Receipts from Federal funds are divided between interest and other interfund receipts.

The definition of income and outgo in this table differs from those in Table 15–1 in one important way. Trust fund collections that are offset against outgo (as offsetting collections) within expenditure accounts instead of being deposited in separate receipt accounts are classified as income in this table but not in Table 15–1. This classification is consistent with the definitions of income and outgo for trust funds used elsewhere in the budget. It has the effect of increasing both income and outgo by the amount of the offsetting collections. The difference is approximately $26 billion in 1999. Table 15–2, therefore, provides a more complete summary of trust fund income and outgo.

The trust funds group is expected to have large and growing surpluses over the projection period. As a consequence, trust fund balances are estimated to grow substantially, as they have over the past two decades. The size of the anticipated balances is unprecedented, and it results mainly from relatively recent changes in the way some trust funds are financed.

Until the 1980s, most trust funds operated on a pay-as-you-go basis. Taxes and user fees were set at levels high enough to finance benefits and administrative expenses, and to maintain prudent reserves, generally defined as being equal to one year's expenditures. As a result, trust fund balances tended to grow at about the same rate as their annual expenditures.

Pay-as-you-go financing was replaced in the 1980s by full or partial accrual funding for some of the larger trust funds. In order to partially prefund the "baby-boomers" social security benefits, the Social Security Amendments of 1983 raised payroll taxes above the levels necessary to finance current expenditures. In 1984 a new system was set up to finance military retirement benefits on a full accrual basis. In 1986 full accrual funding of retirement benefits was mandated for Federal civilian employees hired after December 31, 1983. The latter two changes require Federal agencies and their employees to make annual payments to the Federal employees' retirement trust funds in an amount equal to the value of the retirement benefits earned by employees in that year. Since many years will pass before current employees are paid retirement benefits, the trust funds will accumulate substantial balances over time.

Primarily because of these changes, but also because of the impact of real growth and inflation, trust fund balances increased ninefold from 1982 to 1999, from $205 billion to $1.9 trillion. Under the proposals in the President's budget, the balances are estimated to increase by approximately 82 percent by the year 2005, rising to $3.4 trillion. Almost all of these balances are invested in Treasury securities and earn interest. Therefore, they represent the value, in current dollars, of taxes and user fees that have been paid in advance for future benefits and services.

The President's policy framework in this budget is designed to increase the Government's ability to pay future Social Security and Medicare benefits. However, this enhanced ability to pay does not arise from the building up of large trust fund balances *in and of itself.* When spending exceeds the trust fund's current income, the trust fund can exercise its financial claim on eco-

[5] For example, postage stamp fees are deposited as offsetting collections in the Postal Service fund. As a result, the Fund's outgo is disbursements net of collections.

[4] For example, the Bonneville Power Administration Fund, a revolving fund in the Department of Energy, is authorized to borrow from the general fund, and the Black Lung Disability Trust Fund in the Department of Labor is authorized to receive appropriations of repayable advances from the general fund (a form of borrowing).

Table 15–2. INCOME, OUTGO, AND BALANCES OF TRUST FUNDS GROUP
(In billions of dollars)

	1999 actual	Estimate 2000	2001	2002	2003	2004	2005
Total Trust Funds							
Balance, start of year	1,863.2	1,875.7 [1]	2,099.8	2,340.8	2,598.5	2,860.8	3,130.1
Income:							
Governmental receipts	664.2	698.7	731.9	764.3	794.7	825.8	881.3
Proprietary receipts	46.1	42.1	44.0	46.5	57.2	63.2	69.2
Receipts from Federal funds:							
Interest	120.4	132.8	144.0	157.2	171.1	184.8	199.2
Other	171.0	181.1	204.4	210.7	213.2	230.1	245.3
Subtotal, income	1,001.6	1,052.6	1,124.3	1,178.6	1,236.2	1,303.8	1,395.0
Outgo:							
To the public	787.8	827.4	877.6	919.8	972.8	1,033.4	1,095.8
Payments to Federal funds	1.1	1.1	5.5	1.1	1.1	1.2	1.2
Subtotal, outgo	788.9	828.5	883.0	920.9	973.9	1,034.6	1,097.0
Change in fund balance:							
Surplus or deficit (–):							
Excluding interest	92.3	91.5	97.3	100.5	91.2	84.5	88.8
Interest	120.4	132.8	144.0	157.2	171.1	184.8	199.2
Subtotal, surplus or deficit (–)	212.7	224.3	241.3	257.7	262.3	269.3	287.9
Adjustments:							
Transfers/lapses (net)	*	–0.1	–0.3	....	....	....	....
Other adjustments	–*	–*	–*	....	....	....	....
Total, change in fund balance	212.7	224.2	241.0	257.7	262.3	269.3	287.9
Balance, end of year	1,876.0	2,099.8	2,340.8	2,598.5	2,860.8	3,130.1	3,418.0

* Less than $50 million.
[1] The difference between 1999 end of year balance and 2000 start of year balance is due to the removal of most tribal trust funds from the budget totals. See the discussion regarding changes in the budget classification of tribal trust funds in this chapter for additional information.

nomic resources by converting its holdings to cash – whether the holdings are Treasury bonds or corporate equities. This conversion ultimately represents an exchange of Government (or corporate) financial securities for private sector resources.Thus, in either case, the Government's ability to pay benefits is related to the health of its overall fiscal position and of the economy as a whole, rather than a simple function of trust fund balances.

Increases in trust fund balances *do* strengthen the ability to pay future benefits if the surplus in the trust fund is matched by an improvement in the Government's net financial position. It is in this sense that future benefits can be prefunded. If a trust fund surplus is matched by a corresponding reduction in publicly held debt, then the Government's financial position will be improved. This makes it easier to finance future benefits in two respects. The first, direct effect, is that this debt reduction reduces future interest payments and frees up general receipts to finance the future benefits. The second is that debt reduction increases the resources available for investment in the economy as a whole. Greater investment now increases future incomes and wealth, which will provide more real economic resources to support the benefits, and may prolong the solvency of the trust funds.

Table 15–5, which appears at the end of the chapter, shows estimates of income, outgo, and balances for 1999 through 2005 for the major trust funds. With the exception of transactions between trust funds, the data for the individual trust funds are conceptually the same as the data in Table 15–2 for the trust funds group. As explained previously, transactions between trust funds are shown as outgo of the fund that makes the payment and as income of the fund that collects it in the data for an individual trust fund, but the collections are offset against outgo in the data for the trust fund group. Additional information for these and other trust funds can be found in the Status of Funds tables in the Budget Appendix.

Table 15–6, which also appears at the end of this chapter, shows income, outgo, and balances of four Federal funds—a revolving fund and three special funds. These funds are similar to trust funds in that they are financed by earmarked receipts, excesses of income over outgo are invested, the interest earnings add to balances, and the balances remain available to finance future expenditures. The table is illustrative of the Fed-